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UNITED STATES DEPARTMENT OF AGRICULTURE
Economic Research Service

NATIONAL ECONOMIC SITUATION AND OUTLOOK FOR 1963

Talk by Rex F. Daly, Chief,
Outlook and Projections Branch
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at the 40th Annual Agricultural Outlook Conference,
Washington, D. C., 11:00 A. M., Tuesday, November 13, 1962

The recent slowing in economic activity and mixed trends for major business indicators have brought some concern about the coming year. But a modest gain in the level of economic activity is indicated for 1963. Prospective increases in purchases by consumers, businessmen, and the Government point to some increase in economic activity with gains in consumer purchasing power and in the domestic demand for farm products. Consumer income per person after taxes is up about $3\frac{1}{2}$ percent this year from 1961. Increases in the coming year are expected to be smaller. It is possible, however, that the modest gain in economic growth in prospect could be accelerated. The vigor of the economy and the level of consumer incomes in 1963 will depend to a considerable extent on increases in defense spending and any new legislation affecting taxes. International tensions in recent weeks also have injected a new element into the outlook for 1963. The economic impacts of these events and possible future developments are not yet clear. But a worsening in international tensions usually increases world demands and steps up economic activity.

The farmer's interest in the general economic outlook for 1963 centers around three major impacts on agriculture: (1) Changes in consumer income affect consumer buying and exert a significant influence on the demand for some foods and nonfood farm products. But the influence has been relatively small for farm products as a whole; (2) With about two-thirds of total farm inputs coming from nonfarm industries, price changes in the industrial sector materially influence farm production costs; and (3) Around a third of the total personal income received by farm people comes from off-farm sources. Opportunities for off-farm work, as well as the rate of movement of farm people out of agriculture, depend to a considerable extent on employment opportunities in nonfarm industries.

The Current Economic Situation

The rise in economic activity slackened this summer and fall after a moderate 1961-62 expansion of more than a year. The Gross National Product, which measures the volume of all goods and services produced, was at a rate of \$556 billion in the third quarter. There was a continued rise in consumer spending and in fixed investment outlays from second quarter rates. But a reduction in net exports and in the rate of inventory accumulation limited the increase in the gross product to about 0.5 percent from the second quarter. The rise in industrial production, nonagricultural employment, and personal

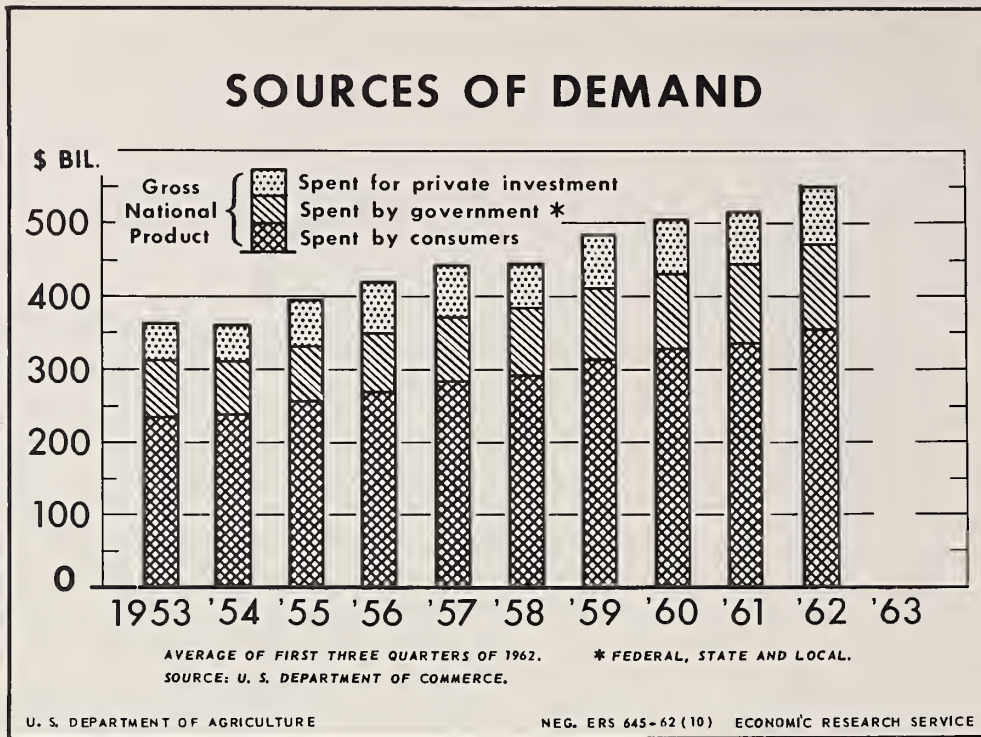


FIGURE 1

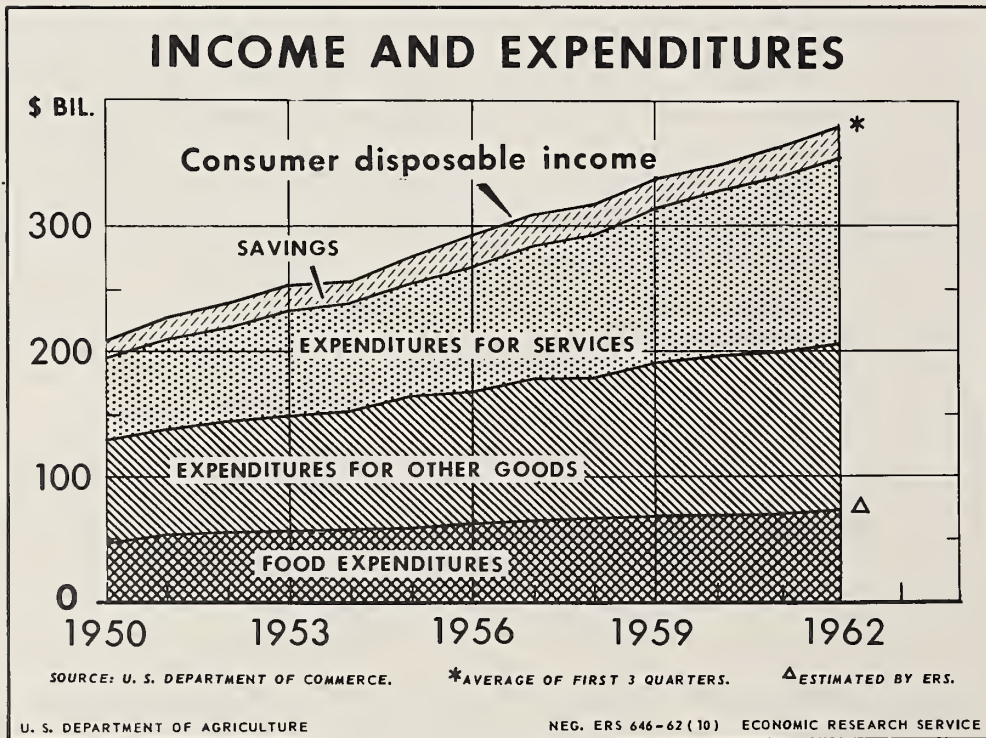


FIGURE 2

incomes leveled off in the July-September period. Unemployment continued at around $5\frac{1}{2}$ percent of the labor force and a number of major industries were operating below capacity. Despite this slackening, the value of goods and services produced in the third quarter was at a rate nearly $6\frac{1}{2}$ percent above a year earlier and consumer disposable incomes were 5 percent higher.

Let us consider briefly each major source of demand which shaped the rise over the past year, as well as the recent slowdown in economic activity. The Gross National Product in the third quarter was at a rate \$33 billion above a year earlier. A little more than half this gain--\$17.5 billion--was in consumer expenditures; Government purchases increased \$12 billion. Approximately half of the \$7 billion rise in fixed investment outlays was offset by smaller net exports and a reduction in the rate of inventory accumulation. (Figure 1).

Consumer Demand

Consumer purchases of goods and services, which account for about two-thirds of total expenditures, increased less than 1 percent in the third quarter to a level 5 percent above July-September 1961. Spending for services increased nearly 6 percent, continuing their persistent uptrend. Expenditures for nondurable goods, a large part of which are foods and apparel, increased 4 percent. Consumer expenditures for food are running about 4 percent above 1961 and outlays for clothing and shoes are about $6\frac{1}{2}$ percent higher. It should be noted, that these increases reflect population growth as well as increases in processing and marketing services. They imply little change in per capita use of farm products. Purchases of durable goods, the most variable component of consumer expenditures, declined some in the July-September period but were still about $6\frac{1}{2}$ percent above a year earlier. Sharply higher automotive sales--up more than a fifth from 1961--and larger purchases of furniture, household goods and other durables contributed to the increase. (Figure 2).

Gains in consumer expenditures accompanied a corresponding rise in consumer income and a small decline in the rate of personal savings. Part of the rise, particularly in purchases of durable goods, was financed as usual by increased use of consumer credit. But repayments on consumer installment credit continued at about 13 percent of personal disposable income.

Business Investment Demand

Business investment in fixed capital and inventories, the more variable components of total demand, are prime movers in changes in economic activity. Business outlays for new plant and equipment have continued to rise since the 1960-61 recession low in the second quarter of 1961. They are expected to total this year a record \$37.2 billion, 8 percent larger than in 1961. However, after adjustment for price changes, estimated real additions to plant and equipment in the past year were a little above the rate in the 1959-60 expansion, but below additions in the 1956-57 expansion. (Figure 3).

Thus, the recent increase in capital outlays has been moderate. Moreover, business surveys indicate that as much as 70 percent of the increase was for modernization and equipment; only about 30 percent for plant expansion.

However, supplies of goods continue generally plentiful and some basic industries, particularly autos and transportation equipment, have been operating well below capacity. Manufacturers new orders for durable goods have fluctuated recently at a level below rates earlier this year. Part of the decline was associated with the cutback in orders for steel as inventories were worked down. Order backlogs have also been reduced as sales exceeded new orders placed with manufacturers.

The ability of business to invest has improved during the past year. Corporate profits after taxes this year are relatively stable at a level more than a fourth above the recession low in early 1961. Gross business savings--undistributed corporate profits and capital consumption allowances--in the second quarter were at a rate of \$57.6 billion, \$7½ billion above first quarter 1961. This gain was double the increase in business outlays for new plant and equipment.

Farm investment outlays for new buildings and machinery and equipment may total in 1962 around 7 percent above 1961. Output of farm machinery and equipment and manufacturers shipments of tractors and other farm equipment in the first half of 1961 totaled around 3 percent above a year earlier. But output of farm machinery and equipment in July and August was nearly a third above the same months of 1961.

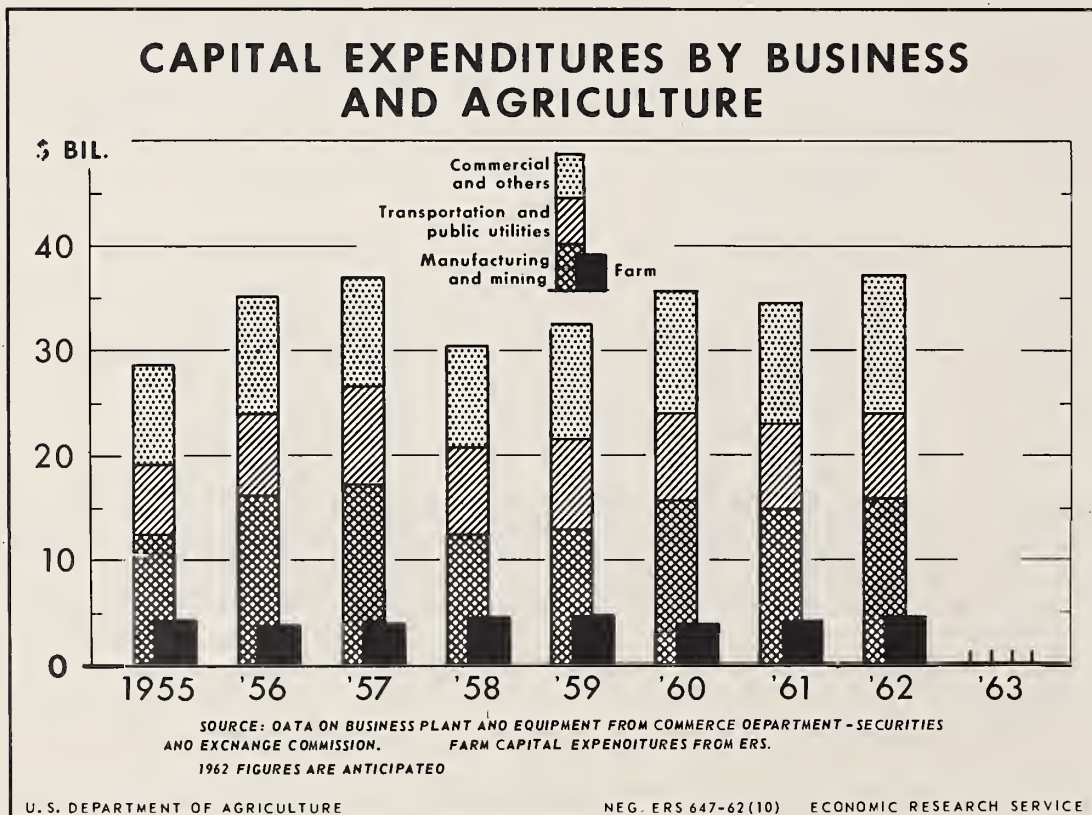


FIGURE 3

Business inventories are responsive to the changes, as well as the anticipated changes, in economic activity. Accordingly, they usually materially influence variations in demand and in the Gross National Product. Due largely to a build-up and subsequent decline in stocks of steel, business inventories grew at a rate of nearly \$7 billion annually in the first quarter of 1962, but were down to a rate of \$1½ billion by the third quarter. Inventories now are relatively low and appear generally well balanced compared to sales.

Residential construction rebounded from a low last February. Through the spring and summer private housing starts held around an annual rate of 1.5 million units. New home starts for 1962 as a whole probably will exceed 1.4 million units, around 6 percent more than in 1961. Expenditures for residential construction this year total 13 percent above the first three quarters of 1961. Increased demand for new homes reflects a rise in new families of about 1.3 million from 1961 to 1962, rising consumer incomes, and a decline in mortgage interest rates. Due in part to the uptrend in number of younger families and to tax advantages, apartment construction has risen in recent years and in 1962 may equal about a third of total housing starts.

Government Demand

Government purchases of goods and services, the third major source of demand, usually take around a fifth of all goods and services produced. These purchases contributed \$12 billion of the \$33 billion rise in the Gross National Product from third quarter 1961 to 1962. Federal purchases in the third quarter

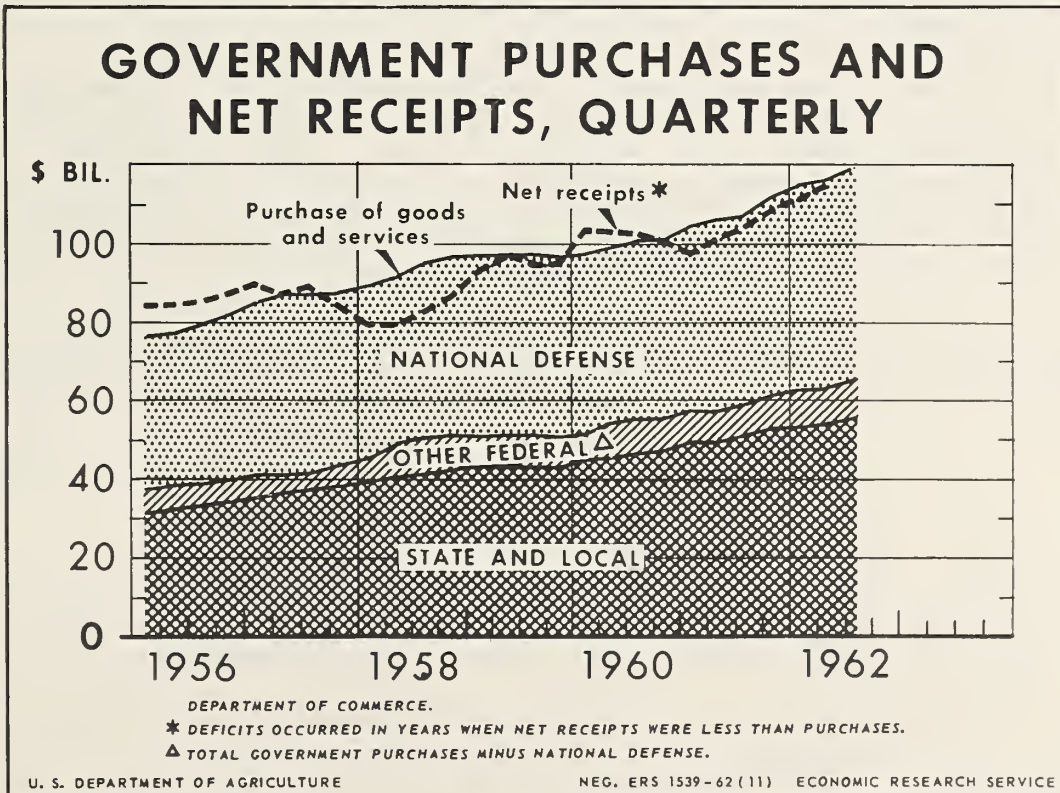


FIGURE 4

were at a rate of \$63½ billion, \$7 billion above a year earlier. Most of this rise was for defense and space activities. Outlays by State and local governments were up more than \$5 billion, reflecting growing demands for services, schools, roads and other public facilities. (Figure 4).

Government revenues also rose with the expansion in economic activity and rising incomes and profits. The deficit on the national income and product accounts was down to a rate of \$1.0 billion in the second quarter this year from an annual rate of nearly \$7.0 billion in first quarter 1961. Rising revenues and the reduction in the deficit greatly moderated the impact on the economy of increased Government purchases.

Output, Employment and Prices

Output and employment trends largely mirror the changes in demand outlined above. The real gross output of the economy rose by less than 1/2 percent in the third quarter. Industrial production and employment also rose less than 1 percent from the second quarter. Compared with a year ago, both real gross output and industrial production in the third quarter were about 5 to 6 percent above a year earlier. Employment increased around 2 percent and the length of the work week about 1 percent. These rough approximations and the rise in gross output imply a further gain in productivity per man hour. Hourly earnings in manufacturing industries rose 2½ percent from the third quarter of 1961 accompanying the increase in productivity and contributing materially to the rise of around 5 percent in consumer disposable incomes during the past year.

Price trends of the past year reflect adequate supplies of most goods as well as excess capacity in some major industries. The recent expansion in demand has exerted little upward pressure on prices. The consumer price index in July-September was around 1 percent above a year earlier; commodity prices were fractionally higher; services were up about 2 percent. Wholesale prices held relatively steady; fractionally higher in total due mostly to the small increase in prices of farm products and processed foods.

Monetary policy has been oriented toward a relatively easy long-term credit situation with comparatively low interest rates and adequate supplies of investment funds. At the same time, it has been necessary to maintain short-term interest rates in order to limit the outflow of short-term capital. Interest rates on Treasury bills have been stabilized this year and yields on longer-term bonds and FHA mortgages have been reduced.

The reduced outflow of capital has helped to improve the balance of payments deficit in the past 2 years. Government grants to foreign countries have remained somewhat above earlier years, while the private capital outflow has been reduced. Measures also have been taken to reduce military expenditures abroad and limit the impacts of foreign aid expenditures on the balance of payments. A slowdown in economic activity in some industrialized countries may limit the attraction for U. S. capital. And rising costs in major exporting countries should help to improve the competitive position of U. S. exports. A slackening in U. S. economic growth will tend to limit imports. Nevertheless, the balance of payments problem will likely be with us in 1963.

General Economic Outlook For 1963

The slackening in economic activity this summer and recent mixed trends in major business indicators give rise to some concern about coming months and 1963. However, the 1961-62 expansion in business activity and the recent slowdown have not led to serious excesses or imbalances in inventories, fixed capital, or consumer buying. There appears to be a firm underpinning in the economy but no indication of a strong expansion in demand. The scheduled rise in Government purchases is expected to be the major expansionary influence on the economy in 1963. In building up the outlook for 1963, let us consider the major demand sources in a reverse order beginning with the Government.

Government Sector

Government purchases will continue to rise in the coming year. Previously scheduled increases plus new legislation now indicate that purchases by the Federal Government in 1963 may total \$4 to \$4½ billion above 1962. Most of the increase will be due to increased spending for national security and space activities. New legislation may add around ¾ billion dollars to the rate of Federal spending. New programs include the \$900 million for accelerated public works in depressed areas and \$600 to \$700 million (annual rate) for the new Federal pay bill. Appropriations also were increased for the public roads program. This increase will affect both Federal and State and local purchases. The uptrend in expenditures by State and local governments will continue and may accelerate some in 1963. Growing demands for schools, hospitals, roads, other facilities, and services are expected to result in an increase in spending of more than \$4½ billion. Thus, combined Government purchases of goods and services in 1963 may total \$8 to \$9 billion above this year. (Figure 4).

Some reduction in revenues will result from stepped-up depreciation allowances under the new guidelines and the 7-percent tax credit for new investment. However, Social Security taxes are scheduled to increase about \$2.0 billion per year beginning next January--about \$1 billion each from employers and employees. Prospective increases in economic activity, under present programs, suggest some further rise in total government revenues in calendar 1963. But expenditures are expected to increase more rapidly than revenues.

Investment Demand

Business spending for new plant and equipment may be rather sluggish in coming months. Recent slackening in total demand, excess productive capacity in some basic industries, little change in new orders, and some reduction in order backlogs all point to a lack of vigor in business investment demand. But demand may strengthen in the latter part of 1963, particularly in view of added incentives and prospects for some increase in economic activity. Except for steel and transportation equipment, recent operating rates for most industries were within a few percentage points of production rates preferred by manufacturers. Business outlays for new capital in 1963 probably will exceed expenditures this year. The recent McGraw-Hill survey of business

capital investment plans for 1963 points to a small increase in capital outlays. Investment by manufacturing industries is indicated very little higher. But the uptrend in capital outlays by the trade, service, and communication industries probably will continue in 1963. These industries accounted for about one-third of total expenditures for new plant and equipment in 1962. (Figure 3).

Capital financing is not expected to be a limiting factor in 1963. New depreciation guidelines, and the tax credit on investment increase funds available for financing new investment. A sizable cut in corporate and personal taxes would expand total demand, increase earnings, and provide added incentive for expanding capital expenditures.

Business inventories are generally well balanced relative to demand, production capacity is adequate, and stocks apparently are well controlled. There is nothing in the domestic business picture to suggest a sharp turn up or down in inventories. Inventory-sales ratios at retail are a little below a year ago; about the same at the wholesale and manufacturer level. Businessmen anticipate some increase in inventories in coming months. Current production rates for autos also may result in some stock buildup from the relatively small end-of-year stocks of 1962 models.

Housing demand in 1963 likely will maintain residential building close to levels this year. A relatively high rate of new family formation will continue in 1963. **Rising numbers** of young people in the marriageable age groups point to an upward trend in the annual increase in new families. Consumer incomes also are expected to rise some in 1963. Continued ample supplies of mortgage funds and the reduced mortgage interest rates are in prospect for 1963.

Nonconsumption Outlays and the Gross National Product

Indicated increases in nonconsumption purchases by Government and business point to a modest gain in economic activity in 1963. This reflects prospects for a high level of investment outlays and a continued rise in Government purchases of goods and services. The increase in nonconsumption spending usually steps up output, employment and incomes sufficiently to result in an approximately equal increase in consumer purchases. Accordingly, an increase in nonconsumption spending usually results in an increase in the GNP about twice as large. This is an oversimplified illustration of a multiplier of 2.0 which approximates changes from the third quarter 1961 to 1962. It should be noted also that in postwar economic cycles, when economic activity stabilized or even declined moderately, consumer income and expenditures were well maintained and in some instances increased slightly. This has tended to moderate swings in total economic activity in postwar business cycles. (Figure 5).

Thus, barring any substantial change in international tensions, a modest gain in economic activity and consumer expenditures is indicated for 1963, though there may be periods of little change in some indicators of business activity. Prospects for another good auto year and high residential construction activity are expected to maintain the demand for durable goods. Further increases in expenditures are in prospect for food and other nondurable goods. And the long-term uptrend in demand for services will continue in 1963. These demand changes sum to a moderate rise in consumer buying next year; a rise which would accelerate if there is a reduction in taxes on personal incomes.

Output increases implied by the moderate expansion in demand in view would be smaller than during the past year. Some further rise in employment is expected, particularly later in the year. However, with rising productivity and further increases in the labor force, unemployment may not show significant improvement from the rate in recent months. Hourly earnings in manufacturing industries in the third quarter averaged more than $2\frac{1}{2}$ percent above a year earlier and a continued rise is in prospect for the coming year. Gains in employment and earnings would result in an increased flow of income to consumers. This moderate rise in economic activity indicated for 1963 is not expected to exert upward pressure on prices. Thus, the general price stability of recent years may well continue in 1963.

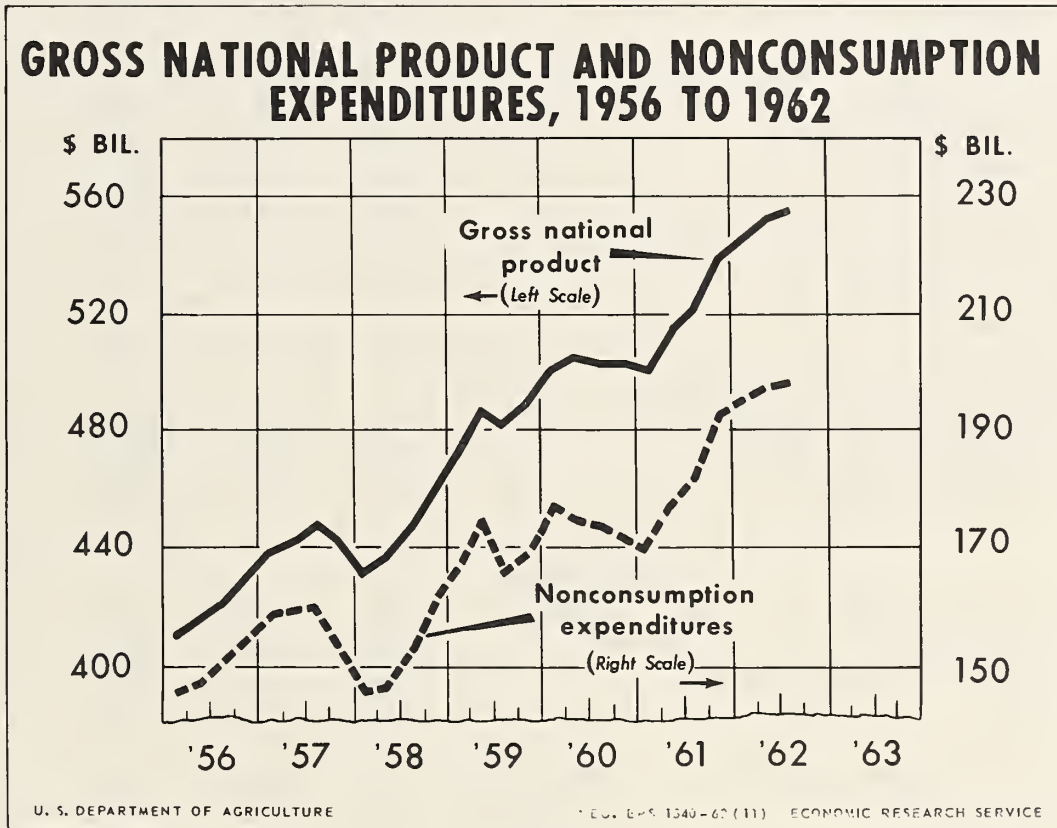


Figure 5

Gross National Product, output, employment and prices, selected quarters 1961 and 1962

(Seasonally adjusted annual rates)

Item	Unit	1961			1962			Net change 3rd quarter 1962 from 1961
		3rd quarter	2nd quarter	3rd quarter	3rd quarter	2nd quarter	3rd quarter	
Gross National Product	Bil. dol.	522.3	552.0	555.5			33.2	
Personal consumption expenditures	"	340.1	354.9	357.5			17.4	
Durable goods	"	44.0	47.2	46.8			2.8	
Nondurable goods	"	156.2	161.3	162.6			6.4	
Services	"	139.9	146.3	148.1			8.2	
Fixed investment	"	68.4	73.4	75.5			7.1	
New construction	"	42.6	44.5	46.1			3.5	
Residential	"	21.9	23.3	24.3			2.4	
Other	"	20.7	21.2	21.8			1.1	
Producers' durable equipment	"	25.8	28.9	29.4			3.6	
Business inventories	"	4.0	4.0	1.5			-2.5	
Net exports	"	2.8	3.7	2.0			-0.8	
Government purchases of goods and services	"	106.9	116.0	119.0			12.1	
Federal (less sales)	"	56.5	62.1	63.5			7.0	
State and local	"	50.4	54.0	55.6			5.2	
							<u>Percent</u>	
Industrial production	Index 1957=100	112	118	119			6.2	
Consumer goods	"	119	124	124			4.2	
Equipment, including defense	"	105	113	117			11.4	
Materials	"	110	115	116			5.5	
Employment, nonagricultural	Millions	61.3	62.6	63.0			2.8	
Unemployment rate	Percent	6.9	5.5	5.6			-18.8	
Prices	1957-59=							
Consumer price index	100	104.4	105.2	105.7			1.2	
Wholesale prices	"	100.0	100.2	100.7			.7	
Industrial	"	100.6	100.8	100.7			.1	